Supreme Court, U.S.
FILED
OCT 24 1979
MICHAEL RODAK, JR., CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79-509

EXXON CORPORATION,
Appellant,

vs.

WISCONSIN DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the
Supreme Court of Wisconsin

MOTION TO DISMISS OR AFFIRM

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MOTION TO DISMISS OR AFFIRM

The appellee moves the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Supreme Court of Wisconsin on the ground that the questions presented by the appellant are so unsubstantial as not to need further argument.

OPINIONS BELOW

The opinion of the Supreme Court of Wisconsin is reported at 90 Wis. 2d 700, 281 N.W. 2d 94 (1979); the opinion of the Dane County Circuit Court is reported at CCH Wis. Tax Reports, par. 201-373; and the

Decision, Findings of Fact and Conclusions of Law of the Wisconsin Tax Appeals Commission is reported at CCH Wis. Tax Reports, par. 201-223.

JURISDICTION

The jurisdictional requisites are set forth in appellant's Jurisdictional Statement.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Commerce Clause (Art. I, §8, cl. 3): "The Congress shall have power ... to regulate commerce with foreign Nations and among the several States, and with the Indian Tribes."

Due Process Clause (Amend. XIV, §1): "[N]or shall any State deprive any person of life, liberty, or property, without due process of law."

Wis. Stats. (1967) §71.07 (1) and (2):

> **Situs of income; allocation and apportionment.** (1) For the purposes of taxation income or loss from business, not requiring apportionment under sub. (2), (3) or (5), shall follow the situs of the business from which derived. Income or loss derived from rentals and royalties from real estate or tangible personal property, or from the operation of any farm, mine or quarry, or from the sale of real property or tangible personal property shall follow the situs of the property from which derived. Corporation income from personal services performed by employes of corporations shall be deemed business income and shall follow the situs of the business. Income from personal services and from professions of

> resident individuals shall follow residence. Income from personal services of nonresident individuals, including income from professions, shall follow the situs of the services. All other income or loss, including royalties from patents; income or loss derived from land contracts, mortgages, stocks, bonds and securities or from the sale of similar intangible personal property, shall follow the residence of the recipient, except as provided in s. 71.07 (7). For the purposes of taxation, interest received on state and federal tax refunds when the tax refunded was on business income or property shall be deemed income from business and shall follow the situs of the business from which derived.
>
> (2) Persons engaged in business within and without the state shall be taxed only on such income as is derived from business transacted and property located within the state. The amount of such income attributable to Wisconsin may be determined by an allocation and separate accounting thereof, when the business of such person within the state is not an integral part of a unitary business, provided, however, that the department of taxation may permit an allocation and separate accounting in any case in which it is satisfied that the use of such method will properly reflect the income taxable by this state. In all cases in which allocation and separate accounting is not permissible, the determination shall be made in the following manner: There shall first be deducted from the total net income of the taxpayer such party thereof (less related expenses, if any) as follows the situs of the property or the

residence of the recipient; provided, that in the case of income which follows the residence of the recipient, the amount of interest and dividends deductible under this provision shall be limited to the total interest and dividends received which are in excess of the total interest (or related expenses, if any) paid and allowable as a deduction under section 71.04 during the income year. The remaining net income shall be apportioned to Wisconsin on the basis of the ratio obtained by taking the arithmetical average of the following 3 ratios:

QUESTIONS PRESENTED

1. Whether the State of Wisconsin's treatment of Appellant as a unitary business has rendered Wis. Stats. s. 71.07 (2) invalid under the Due Process Clause of the fourteenth amendment to the United States Constitution.

2. Whether the State of Wisconsin's formula for taxing unitary businesses results in an unconstitutional tax on a portion of Appellant's income derived from outside the State so as to constitute a construction of Wis. Stats. ss. 71.07 (1) and (2) which renders the statute invalid under the Due Process Clause of the fourteenth amendment to the United States Constitution.

3. Whether the State of Wisconsin's formula for taxing unitary businesses results in an unconstitutional tax on a portion of Appellant's income derived from outside the state so as to constitute a construction of Wis. Stats. ss. 71.07 (1) and (2) which renders the statute invalid under the Commerce Clause of the United States Constitution.

STATEMENT OF THE CASE

This case was commenced by the appellant when it appealed Appellee's denial of its application for abatement of an additional franchise tax assessment for the years 1965 through 1968. The appeal was taken to the Wisconsin Tax Appeals Commission wherein Appellant contended that Appellee's method of taxing Appellant's net income was in violation of both the fourteenth amendment to the United States Constitution, and the Commerce Clause of the United States Constitution. The Tax Appeals Commission found that:

1. Appellant's three main functional operations were each separate unitary businesses;

2. Appellee's apportionment formula improperly included income from sources outside Wisconsin;

3. An apportionment formula apportioning only income earned by Appellant from its marketing function would be proper; and

4. Appellee's assessment subjected part of Appellant's income to multiple taxation.

The Appellee appealed the Commission's decision to the Circuit Court for Dane County, Wisconsin. By order entered on January 31, 1977, that court found that Appellant was a unitary business and that its total income was subject to apportionment by Wisconsin. That court also found that all of Appellant's income from exploration and production should be excluded from apportionment as situs income and that some of Appellant's exploration and production income was being subjected to double taxation.

The circuit court decision was appealed to the Wisconsin Supreme Court on cross-appeals. Appellant appealed the unitary business issue and Appellee

appealed the situs income issue. The Wisconsin Supreme Court affirmed the circuit court's decision on the unitary business issue, and reversed the circuit court's decision on the situs income issue.

Appellant has filed an appeal with this Court to obtain review of the judgment of the Wisconsin Supreme Court. The appellant raises three questions on appeal which are set forth above. It is the position of the Appellee that none of appellant's questions raise a substantial federal question not previously determined by this Court. The Appellee's argument in support of this position follows.

ARGUMENT

I. The Case Presents No Substantial Due Process Question Not Previously Decided By This Court.

A. Wisconsin may properly treat appellant's business as a unitary business.

This Court has long recognized the concept of the unitary business. *Butler Bros. v. McColgan,* 315 U.S. 501 (1942). In concluding that California could properly treat a wholesale dry goods and general merchandise business as a unitary business, the Court stated:

> At least since Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, 17 S.Ct. 305, 41 L.Ed. 683, this Court has recognized that unity of use and management of a business which is scattered through several States may be considered when a State attempts to impose a tax on an apportionment basis. As stated in Hans Rees' Sons, Inc., v. North Carolina, supra, 283 U.S. page 133, 51 S.Ct. page 389, 75 L.Ed. 879,[fn] "*** the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits."

315 U.S. at 508.

The term unitary business has been variously defined. The definition relied on by the Wisconsin Supreme Court, as borrowed from the text authority of Altman & Keesling, *Allocation of Income In State Taxation,* (2d ed.), p. 101, is whether " 'the operation of the portion of the business within the state is dependent upon or contributory to the operation of the

business outside the state.'" 90 Wis. 2d at 711, 281 N.W. 2d at 100. The test relied on by this Court in *Butler Bros.* is whether there exists a unity of ownership and management. 315 U.S. at 508.

Using either approach, the holding of the Wisconsin Supreme Court, that Appellant was a single unitary business, is amply supported by the record. The Wisconsin Supreme Court properly determined that the issue of whether Appellant's operations constituted a unitary business presented a question of law. In arriving at its determination that Appellant's business was unitary the Wisconsin court considered and relied on a series of undisputed factual determinations. 90 Wis. 2d at 714-18, 281 N.W. 2d at 102-04.

The court pointed out that while Appellant's corporate organization consisted of three parts referred to as corporate management, coordination and service management, and operations management, the court was concerned only with operations management, which was the part responsible for directing the operating activities of the individual functional segments of the company.

The three major individual functional segments, or departments, of operations management were Exploration and Production, Refining, and Marketing. Each of these departments had its own management responsible for conducting the operation of the department and a separate profit center where expense and revenue were recorded to determine a profit for that department. The company considered each department a separate investment center.

Company policy required the transfer of products and raw materials between departments to be based upon competitive wholesale market prices. Interdepartmental transfers were accounted for either at

posted industry prices, or at prices determined through "arm's length" negotiations between representatives from the various departments. These prices were recorded in order to determine the performance of each department.

Appellant manufactured and produced motor oils, greases, and other packaged products outside of Wisconsin, and shipped them into the state for sale. It purchased tires, batteries, and accessories through its central purchasing office, and shipped them into Wisconsin for sale. It also transported into Wisconsin gasoline and fuel oil obtained through an exchange agreement with another oil company in order to reduce the cost of transporting gasoline and fuel oil from the source of production to the point of sale.

The Wisconsin Supreme Court pointed out that Appellant has a centrally administered credit card system used nationwide; that it promotes its products by uniform packaging and brand names; that it uses centrally designed promotional display equipment; and that its overall distribution plan is developed at its central office. It also pointed out that key employes are frequently transferred from one department to another.

The court, while indicating that Appellant had no production or refining functions in Wisconsin, stated:

> What emerges from this pattern of organization is that Humble's production and refining functions depended upon the marketing operation to provide an outlet for its products. Wisconsin was a part of Humble's marketing system. In a high capital investment industry such as the petroleum industry, the existence of a stable and assured marketing system is important for the full utilization of refining capacity. This was the

> testimony of a top Exxon executive who admitted that the profits of the overall corporation depend on the profits of each of the individual functional segments.

90 Wis. 2d at 718, 281 N.W. 2d at 104.

The testimony the Wisconsin Supreme Court was referring to came from Oral Luper, a senior vice president of Appellant, wherein he explained why the separate corporate departments were organized under one corporate entity.

> " ... [I]n any industry which is highly capital intensive, such as the petroleum industry, the fixed operating costs are highly relative to total operating costs, and for this reason the profitability of such an industry is very sensitive and directly related to the full utilization of the capacity of the facilities.
>
> "So, in the case of the petroleum industry ... where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important, and therefore when there are — when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time."

90 Wis. 2d at 716, 281 N.W. 2d at 103.

Thus, Appellant's own witness demonstrated that unity of ownership and management is directly related to the maintenance of corporate-wide profits and

thereby supplied the very basis for the wide acceptance of the concept of the unitary business.

The Oregon Tax Court, in a case involving the same corporation and nearly identical facts, held that Appellant's activities in Oregon were part of a unitary business although its Oregon operations dealt almost exclusively with marketing. That court in *Humble Oil & Refining Company v. Dept. of Revenue,* 4 OTR 284 (1971), commented:

> Humble Oil & Refining Company is a large vertically integrated corporation engaged nationwide in all phases of the petroleum industry, from discovery through production and manufacture to marketing. It has unity of ownership, operations, management, control and products; and strong centralized credit, purchasing, advertising, accounting and legal services. All segments of plaintiff's business have a great deal in common and contribute to and are dependent upon each other. The plaintiff is actually a single interrelated unitary business operation. The component parts, including those in Oregon, are too closely connected and necessary to each other to be considered as independent units.

4 OTR 292.

The finding by the Wisconsin Supreme Court that Appellant's business was unitary is consistent with the *Butler Brother's* holding. It presents no substantial due process question not previously decided by this Court.

B. *Subjecting income from Appellant's unitary business to apportionment does not violate the Due Process Clause of the fourteenth amendment to the United States Constitution.*

In *Butler Bros.* this Court said: "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. See Norfolk & Western Ry. Co. v. North Carolina, 297 U.S. 682, 688, 56 S.Ct. 625, 628, 80 L.Ed. 977." 315 U.S. at 507.

The Appellant suggests that its analysis based on separate functional accounting establishes that Wisconsin is attempting to tax income which has no reasonable relationship to the taxing state. The State of Wisconsin submits that while its formulary apportionment approach to Appellant's business does not necessarily identify the precise geographical source of income, it is a reasonable, if not the best possible, method of apportioning income from a unitary business.

This Court in *Moorman Mfg. Co. v. Bair,* 437 U.S. 267 (1978), rejected the claim that the Constitution invalidates an apportionment formula whenever the formula might result in taxation of some income which did not have its source in the taxing state. The Court recognized the imprecision of a formulary approach but stated: "Yet despite this imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula." 437 U.S. at 273.

However valuable or necessary Appellant's accounting system may be as a business aid, it does not prove Appellant's claim that Wisconsin is taxing

extraterritorial income. As stated by this Court in *Butler Bros.*:

> Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore. A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 121, 41 S.Ct. 45, 47, 65 L.Ed. 165, that a State in attempting to place upon a business extending into several States "its fair share of the burden of taxation" is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." Furthermore, the particular system used may not reveal the facts basic to the State's determination. Bass, Ratcliff & Gretton, Ltd., v. State Tax Commission, supra, 266 U.S. page 283, 45 S.Ct. page 84, 69 L.Ed. 282. In either aspect of the matter the results of the accounting system employed by appellant do not impeach the validity or propriety of the formula which California has applied here.

315 U.S. at 507-08.

The Wisconsin formula, like the California formula at issue in *Butler Bros.,* is a method of apportioning income of unitary businesses in a manner calculated to assign to Wisconsin "that portion of the net income 'reasonably attributable' to the business done there."

315 U.S. 506. Appellant's contention that the Wisconsin formula attributes to Wisconsin a percentage of income all out of appropriate proportion to business transacted by the appellant in Wisconsin is refuted by the opinion of the Wisconsin Supreme Court wherein it is pointed out that Appellant's Wisconsin sales for the four years in question represented only 41/100 of one percent of its total company sales; and the Wisconsin assessed taxable income for the four years represented only 22/100 of one percent of total company net income. 90 Wis. 2d at 729, 281 N.W. 2d at 110.

The nexus requirement of *National Bellas Hess, Inc. v. Department of Rev.,* 386 U.S. 754, (1967), that a state may not impose a tax unless there is some minimum connection between the activities of the taxpayer in the state and the taxing state is amply satisfied by the fact that for the four year period in question the Appellant had sales in Wisconsin in the amount of $60,073,293. The *National Bellas Hess* case does not support Appellant's contention that since there are no exploration and production activities by Appellant in Wisconsin, there can be no connection between such activities and the State. Such a contention, ignores the very nature of the unitary business and the reason why most states now use some method of formulary apportionment. The multistate and multinational centrally managed businesses of today are little affected by state or national boundaries.

Thus, while the Appellant's separate functional accounting system may be useful as a business aid, it is, as pointed out by the Wisconsin Supreme Court, "incompatible with the

> ' very essence of formulary apportionment, namely, that where there are integrated, interdependent steps in the economic process carried on by a business enterprise, there is no

> logical or viable method for accurately separating out the profit attributable to one step in the economic process from other steps. It is for that reason that the States have resorted to formulary apportionment — unrefined and approximate though the results may be — in the case of an enterprise engaged in manufacturing and selling, where the activities take place in more than one State. Essentially, the same inherent difficulties are present in seeking to divide the profits of an oil company, where producing manufacturing and marketing take place in different States. Hellerstein, *State And Local Taxation,* (3rd Edition, 1969), p. 400.' "

90 Wis. 2d at 726, 281 N.W. 2d at 109.

Subjecting Appellant's unitary business to apportionment under Wisconsin's three-factor formula presents no substantial due process question not previously decided by this Court.

II. The Case Presents No Substantial Commerce Clause Question Not Previously Decided By This Court.

Appellant's assertion that Wisconsin's apportionment formula violates the Commerce Clause of the United States Constitution because it includes income from Appellant's exploration and production operations is incompatible with the formulary apportionment approach to the taxation of income from multistate unitary businesses. The rationale behind formulary appointment is that income from a unitary business cannot be accurately or logically attributed to a particular step in the economic process. Under the unitary business approach to taxation of large multistate businesses the Wisconsin apportionment formula does not impose a tax measured by any income from Appellant's business which is not properly apportioned to Wisconsin.

The multiple or duplicative taxation claim of Appellant is without merit. As pointed out by the Wisconsin Supreme Court, there is no evidence that Appellant was taxed on more than 100% of its total net income. 90 Wis. 2d at 729, 281 N.W. 2d at 110. Wisconsin can hardly be accused of reaching beyond the limits of constitutional mandates in view of the fact that Wisconsin's assessment of taxable income for the period in question represented only 22/100 of one percent of total company income and for the same period Wisconsin sales constituted only 41/100 of one percent of total company sales.

Although in the instant case there is no evidence of duplicative taxation by Wisconsin, the Commerce Clause does not prohibit some overlap in the computation of taxable income. Thus this Court in *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, concluded that the Iowa

single-factor sales formula did not violate the Commerce Clause even though some corporate income might be doubly taxed. Although noting that the record did not demonstrate the fact of duplicative taxation, the Court said that even assuming some overlap, the Commerce Clause by itself does not prohibit overlap in the computation of taxable income by the state.

> If the Constitution were read to mandate such precision in interstate taxation, the consequences would extend far beyond this particular case. For some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income. Accepting appellant's view of the Constitution, therefore, would require extensive judicial lawmaking. Its logic is not limited to a prohibition on use of a single-factor apportionment formula. The asserted constitutional flaw in that formula is that it is different from that presently employed by a majority of States and that difference creates a risk of duplicative taxation. But a host of other division-of-income problems create precisely the same risk and would similarly rise to constitutional proportions.

437 U.S. at 278.

The *Moorman* case appears to be Appellant's sole authority to support its position with regard to its Commerce Clause argument. The holding of that case does not support Appellant's position. It does not render Wisconsin's tax invalid.

The State of Wisconsin's formulary apportionment approach to taxation of large multistate unitary

businesses recognizes the economic realities which result from the existence of such enterprises. Wisconsin has not, by taxing 22/100 of one percent of Appellant's income, extended its grasp beyond constitutional limits. Appellant cannot show that the tax discriminates against interstate commerce or that it creates an undue burden on such commerce. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).

Thus, subjecting Appellant's unitary business to apportionment under Wisconsin's three-factor formula presents no substantial Commerce Clause question not previously decided by this Court.

CONCLUSION

Wherefore, Appellee respectfully submits that the questions upon which this cause depends are so unsubstantial as not to need further argument, and Appellee respectfully moves the Court to dismiss this appeal or, in the alternative, to affirm the judgment entered in the cause by the Supreme Court of Wisconsin.

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